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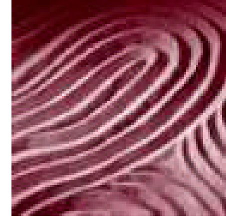

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Tackling Troublesome Franchisee Insolvency Issues for Franchisors

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2003

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TACKLING TROUBLESOME FRANCHISEE INSOLVENCY ISSUES FOR FRANCHISORS

I. INTRODUCTION

Law and practices affecting franchised businesses has experienced many recent changes in Canada. In particular, the advent in Ontario of *The Arthur Wishart Act (Franchise Disclosure) Act*, 2000, S.O., c.3., implemented in two phases in 2001 and 2002, has attempted to codify and change the landscape for businesses operating under franchise arrangements in that province. This followed the implementation of the revised and ground-breaking Alberta statute, the *Franchises Act,* R.S.A. 2000, c. F-23, most recently revised in 1995. Several provinces are looking to implement similar changes and improvements to their laws relating to franchised businesses.

However, there have also been revisions and proposed changes in other statutes which do or may affect the sale, operation, and closure of franchised businesses, also creating a significant impact. These proposed and actual changes have occurred in both provincial and federal statutes, including the *Bankruptcy and Insolvency Act* R.S.C. 1985, c. C-36 (the "BIA"), *An Act to Amend the Competition Act and Competition Tribunal Act* (Bill C-23), *The Consumer Protection Law Statute* (Bill 180) Ontario, the draft Ontario bill entitled *The Privacy of Personal Information Act* (PIPA) to be implemented in early 2004, and others which will be addressed by other speakers over the course of this program.

The evolution of class actions by franchisees against franchisors, the concept of bad faith dealings at inception and over the course of the franchise relationship, the changes in the BIA, continuing practices and decisions under the *Companies Creditors Arrangements Act*, R.S.C. 1985, c. C-36 ("CCAA") have all had an impact on the day to day operations of the franchise networks.

Many of the problems that exist between franchisees and franchisors and their stakeholders, including suppliers, landlords, the Canada Customs and Revenue Agency ("CCRA") and other government agencies, guarantors, investors and creditors continue to create challenges. The approaches available to such parties in solving such challenges are changing with the evolving statutory and common law environment. However, many of the most vexing problems relating to insolvency of a franchisee remain, and the solutions rest in the particular fact situations of each case.

The focus of this paper is to examine these challenges from the perspective of a franchisor when dealing with the insolvent franchisee, and deals only with problems arising out of insolvency situations. Franchise problems arising for reasons other than insolvency are covered elsewhere in the course.

II. THE FRANCHISE BUSINESS MODEL

The franchisor and franchisee each may benefit from the franchise business model.

The franchisee generally acquires rights in the existing goodwill of the franchisor, including:

- a proven brand or product in the market place,
- some broadly based advertising and branding, the use of trade marks and licences that would otherwise not be available to them,
- arguably less marketing and administrative duties,
- the benefits of a proven training program and accounting system together with other support systems and services, and
- some cost benefits from the pooling of purchase discounts and rebates arising out of the operation of the network created by the franchisor.

However, the franchisee sacrifices a large degree of control and autonomy, and may not appreciate the omnipresent overview of the franchisor. Further, the franchisee may not always get an equal or proportionate share of the benefits of belonging to the franchise network. The franchisee may experience a significant degree of frustration or alienation if the location or the franchise is not profitable, or where it is not afforded enough support to turn the operation around and make it profitable. The culture and integrity of the franchise network, and the cumulative experiences of individual franchisees can have a direct and significant impact on the options available to insolvent franchisees, and their reactions in times of financial crisis.

The franchisor also benefits from this business model. The franchisor is able to reduce the cost and risk of expansion through the use of the franchisee's capital, creditworthiness, and in some cases community connections. The franchisees assume a large degree of the risk of location-based expansion, as is common with food-based and other forms of franchise models. Other liabilities, such as employer liabilities can be mitigated or eliminated. This may act as a structuring technique for discouraging the proliferation of employer liabilities, including the creation of unions and bargaining units in the expansion of the franchised business.

In addition to avoiding or eliminating liabilities for *Employment Standards Act* and termination/notice liabilities, the franchisor acquires a highly motivated and not necessarily very well paid franchisee, at least in the initial stages. The franchisor potentially creates a captive market for the supply of equipment, raw material and finished goods inventory, signage, consulting and other services, and leased locations. For this, the Franchisor can obtain a revenue stream from royalty payments, together with a percentage share of gross or net revenues of the franchise. As noted above,

revenues may be available from third parties in the form of volume rebates, lease inducements, and other forms of third party revenues, some of which may be disclosed to or passed on to some or all of the franchisees.

i. Franchise Agreement

The franchise agreement apportions the duties and responsibilities of the parties, and defines the business practices and methodology of the business. The franchise agreement will usually contain several key provisions, including:

- the lease or sublease of the location(s)
- patent or trade mark agreements and licences
- payments of royalties and other fees
- centralized accounting or reporting mechanisms
- promissory notes, vendor take-back financing arrangements, PPSA security agreements and security interests
- restrictions on the conveyancing of the assets and undertaking of the franchise without the express prior written consent of the franchisee
- tied selling arrangements with key suppliers
- covenants and restrictions with respect to confidential information
- events of default

It usually contains a system of waivers, acknowledgements, indemnities, covenants, representations and warranties that are intended to protect the interests of the parties, but most often those of the franchisor.

In most situations, the franchise agreement reflects the relative bargaining position of the parties at the time it is executed and delivered. More often than not, this means that it is weighted in favour of the franchisor[1]. The document is presented to the prospective franchisee, who is informed that he or she has gone through a rigorous screening process, and he or she is to review the document, possibly with a lawyer, and sign off with very few, if any, negotiated changes. The result is usually not one that favours the franchisee.

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[1] However, this can be reversed in certain 'master franchise' or licencee situations: Kentucky Fried Chicken Canada v. Scott's Food Services Inc., [1998] Court File C28208 (Ont. C.A.)

ii. Good Faith and Fair Dealing

The franchise agreement is the central contractual document in this arrangement, and is intended to substantially capture the relationship of the parties. However it is not a code unto itself. There now exists (in Ontario and Alberta) an overriding statutory implied duty of good faith and fair dealing, which cannot be waived by the provisions of the franchise agreement. This generally creates a statutory right to recover damages by the aggrieved party for events occurring after June 8, 2000 under the Ontario Act. However, the Ontario courts have recognized a common law duty to act in good faith that applies to events occurring prior to that date, and applies to all agreements created before and after that date[2]. This common law duty is recognized in several other provinces in circumstances where the courts find an imbalance of power in the agreement, and where oppressive conduct of the dominant party is under attack. For example, such non-statutory remedies may be found where, in the eyes of the court, a dominant party conducts itself in such a way as to cause significant harm, or nullify the actual or implied benefit of the contract to the subordinate or aggrieved party without sufficient or reasonable justification[3].

iii. Fiduciary Duties

In some circumstances fiduciary obligations may be imposed in such relationships. However, fiduciary relationships between the parties are not created automatically by the existence of the franchise agreement itself, but are created out of exceptional circumstances[4]. Fiduciary duties will not be found to exist where the franchise agreement expressly excludes such duties.

iv. Franchisor as the Landlord or Party to the Lease

Another important part of the relationship between franchisor and franchisee is the lease of the property where the franchisee intends to carry on its business. The goal of the franchisor is to protect the goodwill of the business, and that may involve protecting the strategic location and property upon which the business is located. The location may have value and exposure, or may have acquired a particular cachet because of its location which may be of value to the franchisor. Further, the location may contain assets of the business which cannot easily be replaced or removed in a cost-effective manner. This may affect the ability to re-sell the location to a subsequent, and hopefully more successful, franchisee.

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[2] Katotikidis v. Mr. Submarine Ltd., [2002] O.J. No. 1959 (S.C.) where the actions of the franchisor gave rise to a finding of a breach of the duty to act in good faith, at common law, and an award including punitive damages was awarded to the franchisee.

[3] Shelanu v. Print Three Franchising Corp., (2003-05-20) ONCA C35392

[4] Beaucage v. Grand & Toy Ltd., [2001] O.J. No. 5128 (S.C.J.)

In some cases, the franchisor has found an ideal location for the business and has entered into a head lease with a landlord. Later, when the franchisee enters into the franchise agreement with the franchisor, it becomes a sub-tenant of the franchisor thereby creating a landlord and tenant relationship in addition to the franchise relationship.

Alternatively, the franchisor may own the property, and seek to lease the premises directly to the franchisee. Again, this creates the landlord and tenant scenario between the parties.

Finally, the franchisee may have entered the lease agreement directly with the landlord without the involvement of the franchisor. However, the franchisor may have acquired a right of assignment of the leasehold in the event of a default or insolvency of the franchisee. Often, these arrangements will contain a right of first refusal to the franchisor if the franchisor is prepared to enter into the covenant under the lease.

v. Other Interested Parties

The financial affairs of the parties are affected by the rights of creditors including banks, suppliers, landlords, and others.

Landlords

Landlords may have entered into a lease with the franchisor only, and are only looking to the franchisor's covenant. There are other situations where the franchisee has entered into the lease directly, with or without a right of first refusal to the franchisor to move in on expiry or default of the tenant/franchisee, as noted above.

Guarantors

The family or business associates of the franchisee may have guaranteed the obligations including royalty payments and lease obligations, and possibly the purchase price of the franchise in an earn-out or vendor take-back financing situation. Further, these same individuals may have entered into limited or unlimited guarantees to the bank or operating lender, on either a several or a joint and several basis. Most government guaranteed loan situations involving the Small Business Loans Act ("SBLA") limit the extent of such guarantees. Most guarantees given for SBLA loans are not secured. Non-SBLA guarantees are often for the full liability, and are often secured. In a common scenario, the banks have security in support of the personal guarantees, but the franchisors do not hold security for the guarantees they hold from the same people. In a situation of conflicting objectives with between the bank and the franchisor, the cooperation of the guarantor/franchisee may be directly effected by who holds the secured guarantee. That is usually favourable to the banks.

Franchisors have the additional problem of accounting for their behavior in dealing with the franchisee if they seek to enforce a guarantee. For instance, in Jumbo Systems Inc.

v. Short [5], the court indicated that the franchisor's conduct in not disclosing a leasehold inducement could have been grounds for vitiating the obligations under the guarantees. Similarly, in Country Style Food Services Inc. v. 1304271 Ontario Inc. [6], the franchisor was unable to collect in an earlier judgment against the guarantors of a failed franchise because the franchisor had not satisfied its duty to protect the franchisee against the harmful actions of the third-party landlord. It is safe to say that a court can be expected to find that guarantees are unenforceable where the conduct of the franchisor constitutes bad faith and high-handed dealing [7] .

Banks

An unfortunate fact of life for franchisors and franchisees is that their franchisees have frequently heavily leveraged their future returns and operations with debt. Accordingly, the reaction of a bank to the insolvency of its customer usually is significant in dealing with the interests of the franchisor in the failed franchisee.

The SBLA is the federal loan guarantee program in Canada that has allowed a large number of loans to be created by the chartered banks to and in favour of many franchisees. These loans have been made to borrowers who may otherwise not have qualified for the loans. The loans are and were guaranteed to a limited extent by the federal government to the banks, on certain terms and conditions that have been modified from time to time under the various revisions to the program.

Under this and various other loan programs, the common scenario is for the banks to take a first charge in the inventory and equipment of the franchisee. The landlord and /or franchisor may or may not be asked to enter into an estoppel letter or subordination or postponement agreement which acts to forestall, delay, or subordinate the rights and remedies to the interests of the banks. This could include a bar on the right to terminate the lease or franchise agreement without prior notice to or consent of the applicable bank. In some cases, although very rare, a charge or postponement of the leasehold has also been obtained, and the franchisor has entered into a form of waiver, postponement, or subordination to the Bank.

The result is that the bank may commonly hold a first charge in inventory, equipment, "undertaking", and sometimes leasehold improvements (which may include fixtures intended to form part of the realty) or "trade fixtures" [8]. The "undertaking" of a business is a term commonly used in the Bank's standard forms to denote the right, title, and interest of the franchisee in the goodwill and intellectual property of the franchisee,

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[5] [2000] O.J. No.56

[6] [2003] O.J. No. 362

[7] 1005633 Ontario Inc. v. Winchester Arms Ltd., [2000] O.J. No. 2404

[8] Where PPSA fixture filings have been properly registered under s. 54 of the PPSA (Ontario).

including the customer list, phone numbers, municipal or other regulatory licences[9], to the extent only that the franchisee has such rights. The right, title, and interest of the bank in the undertaking is or can be hotly contested in the realization scenario, but the general rule is that the bank has no better right to the goodwill of the business than did the insolvent franchisee.

The interests of the bank will not always agree with the objectives of the franchisor. The bank wants to maximize the recovery from the assets in the shortest possible time. The bank may, in certain SBLA situations, also be concerned with preserving the government guarantee on the loan program, with an eye to the worst case scenario and the resulting submission of a claim in Ottawa. This can sometimes lead to decisions made by receivers acting for the bank that are not in the best interests of the franchisors. For example, the bank may decide that its best interests are served by bankrupting the franchisee for realization purposes. This may not create a favourable scenario for the franchisor who wants to prevent the resulting damage to the brand, and the situation of a trustee disclaiming either licences, or leases at locations not controlled by the franchisor.

Accordingly, the franchisor may likely be forced to deal with a bank, either directly or indirectly through the Bank's privately or court-appointed receiver. It is usually best to approach the bank to find common ground as quickly and as early as possible

CCRA

In general terms, Canada Customs and Revenue Agency ("CCRA") holds an undisputed first position in the assets and undertaking of the insolvent franchisee by virtue of the statutorily created "super-priorities" for unpaid tax remittances. These include a priority for unremitted Goods and Services Tax ("GST") in non-bankruptcy cases, and for the proceeds of enhanced garnishments available to it under the Income Tax Act (Canada)[10]. These interests usurp the position of all secured, preferred, and unsecured creditors [11]. Their place at the "front of the line" can affect all aspects of the insolvency, and how quickly it proceeds.

Suppliers and 30-day Goods

Suppliers can be critical to the success of the franchisee, or its successor. Generally, they are unsecured creditors, and as such are the victims of the insolvency. However, they may have certain rights to the recovery of property under the characterization of their goods as 30-day goods. The restrictions and limitations of s. 81.1 of the BIA make

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[9] Note: liquor licences are usually not assignable, and are further terminable on bankruptcy or receivership, as are other forms of licences and quasi-licence rights, including quotas.

[10] Please refer to the papers of Diane Winters of the Ministry of the Solicitor General's office, which are updated on a regular basis.

[11] s. 136 of the BIA.

this a very narrow right, as the goods must be segregated, distinct, not mixed with other product, and delivered within the 30 day period before the date of bankruptcy, among other requirements. Where the goods are delivered by the franchisor, those rights may exist in favour of the franchisor. These rights usually come in to play in receivership or CCAA scenarios, and are more important in non food-industry franchise networks. However, the remedy is not commonly a very accessible one, and may simply act to help the franchisor in recovering some of its product from the bank and its receiver.

III. INSOLVENCY OF THE FRANCHISEE

The reasons for a franchisee insolvency are many and varied, including inadequate capitalization, inadequate skill in operations and management, dishonest employees, bad location, perceived or actual inadequate support from the franchisor, personal problems, and increased competition from competitors, to name a few.

There are many circumstances where otherwise solvent franchisees find themselves in a distress or termination situations. These situations include shareholder disputes, matrimonial battles, non-monetary default including dishonesty, false or misleading financial reporting, and a myriad of other causes. Some of the principles set out below may also be applicable to those situations.

The risk of the financial failure of the business is a risk shared by the parties to the franchise agreement, and the franchisor needs to adequately anticipate and deal with these situations. The failure of individual franchisees is a virtual certainty in most of the large franchise networks, no matter how large or successful they are.

In such circumstances, the franchisor will have several concerns, depending upon the stage at which the insolvency of the franchisee is known or reasonably anticipated. These concerns will include control of the lease and location, whether or not to preserve or terminate the franchise agreement, how to deal with an insolvency proceeding initiated by either the franchisee or its' lenders (usually an operating lender), recovery of arrears of rent or royalties, retention of key employees, preservation of the goodwill and branding of the franchise network, and transition/sale of the affected location to a new (and hopefully more solvent) franchisee.

There many various types of franchised businesses, each of which will put varying degrees of emphasis on the approach and the stage at which such action are to be taken. For instance, there are many large franchise networks where the franchisee/manager is little more than an employee/manager. Under such circumstances, the franchisors have complete and almost unfettered control over every aspect of the business, including hour by hour access to the deposit and cash-flow information. These franchisee/managers can be replaced relatively quickly and seamlessly, and their complete cooperation is usually obtained throughout the entire process.

Other franchise networks are situations where the franchisee is truly independent, and the degree of control of the franchisee by, and information available to the franchisor is

much reduced. In these situations, reacting quickly and with the forced cooperation of the franchisee is much more difficult, and carries more risk for the franchisor. The case law over the last few years has also highlighted the risk to franchisors from class actions and the increased willingness of the courts to find the existence of fiduciary duties, as set out below.

i. Remedies available to Franchisors

The franchisor wants to preserve the location, the integrity of the brand and location, and to get another operator/franchisee in there as quickly as possible. They also want to recover the royalty arrears. The franchisee may either be fighting to stay open, attempting to find another buyer for the location, or may have simply given up and is simply hoping to minimize its exposure under the guarantees (explored in Mr. Goldman's paper below).

The parties involved need to recognize the dynamic of the situation early, and decide whether or not to act cooperatively in either closing down and winding up the business, or engineering a transition to either a corporate store or to a new franchisee. If a bank or landlord is involved, with or without a receiver, the failure to reach common ground will result in a situation where the bank or the landlord's agenda will govern without regard to the concerns and goal of the franchisor. The decision tree for franchisors in such circumstances is usually the following:

- how valuable is this particular franchise or franchise location to the franchisor and the franchise network?

- how much information does the franchisee have? What caused the problem, and how bad is the financial situation of this franchisee? Was it caused by the franchisee, or is there an inherent flaw in the franchisee's location, the franchise network itself, or some other critical business factor?

- will another franchisee solve the problems on a go-forward basis, or is this market, location, or product dead in the water no matter who comes in?

- can the franchisor run it as a "corporate store" or corporate operation on its own until the best candidate is found? If so, how much will it cost? How long will it take? What will the franchisor end up with at the end of the process?

- is the relationship with this bank important? Does this bank fund other franchisees in the network? Will future financing of new franchisees be jeopardized under an existing loan program with this bank if this franchisor chooses to move against the interests of the bank?

The solutions to an individual franchisee problem are fact driven, and there are many variations depending on the type and location of the business. With more information in the hands of the franchisor at an earlier point in time, the franchisor has a wider array of options to choose from in achieving its goals to solve the problems. This can take various forms, including intervening by early and extraordinary assistance for the

franchisee, or otherwise terminating the franchise agreement, realizing on any security agreements it may have by appointment of a "soft" or full receivership, or acting on its various lease remedies.

In many cases, the franchisor will know of a problem long before the bank payments are in default, and can intervene with the introduction of a new franchisee after termination of the franchise agreement, or upon achieving the agreement of the franchisee to withdraw voluntarily. A seamless transition to a new franchisee, including the introduction of a new operating lender who pays out the bank facility is usually the best result for all parties. However, early recognition of the problems and attendant solutions is the key factor in achieving any such result.

Foreclosure or Power of Sale

Where the franchise agreement contains a granting of a security interest in the assets of the franchised business, the franchisor can avail itself of the remedies under Part V of the PPSA (Ontario) and the equivalent provisions in companion statutes in other provinces, and the BIA. The security interest is usually contained in a separate general security agreement, or in the franchise agreement itself. The appropriate notices under s.244 of the BIA are delivered by the franchisor to the franchisee, in addition to any other notices called for in the franchise agreement. After the passage of the statutory 10 day notice period, or shorter where the either the franchisee consents to the franchisor acting within that period, or where a court orders otherwise, then the franchisor can elect to proceed to sell the collateral under a power of sale, or elect to keep the collateral in lieu of the debts of the franchisee to the franchisor under the appropriate foreclosure regime[12].

The foreclosure remedy is not a common one because of the fact that it extinguishes the residual of the unpaid debt, and precludes enforcement of the guarantees. However, this remedy may be attractive where there are no guarantees, the franchisee is personally insolvent, and where the value of the assets exceeds the amount remaining to be paid to the franchisor. If the disparity between the debt owing and the value of the assets is too large, then the assets are likely to be redeemed by another interested party, such as the bank or the shareholders of the franchisee.

The more common remedy is the power of sale. This usually involves the appointment of a receiver or receiver and manager under the security. The receiver can be privately appointed, and thus subject to retroactive scrutiny by the bank and guarantors and other interested parties. Such a receiver is an agent of the franchisor, is bound to act in a commercially reasonable fashion at all times, obtain full value for the assets, and act on its own with respect to all of the difficult decisions in running the business. Alternatively, the franchisor can elect to proceed with a court-appointed receiver or interim receiver under one or all of the BIA, the PPSA, and s.100 of the Courts of Justice Act (Ontario). Such a receiver is an agent of the court, not of the franchisor. Its actions can be directed

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[12] S. 65(2) PPSA (Ontario)

by the court by way of an initial appointment order, sometimes made on an ex parte basis, and followed up with various subsequent orders for advice and direction on various troublesome issues. These issues are usually dealt with in the initial order, and can include environmental, employment, product liability, and leasing and contract issues with third parties. It is a more expensive way of proceeding, but can remove much of the risk for decisions that are made because it is a more open proceeding. This is now the most common form of sale proceeding by franchisors, notwithstanding the expense. This is because it removes the possibility of fighting rearguard actions after the realization proceedings, as the court is sanctioning the proceedings at each stage, and the affected parties have a concurrent forum to complain about or amend the course of the proceedings.

Landlord remedies

Where the franchisor is the landlord by way of either ownership or by head-lease, it has the ability to exercise the following rights, in addition to its rights under the security interests under the franchise agreement:

- distress is a self-help remedy, levied upon the tenant/franchisee's assets. It is available as long as the lease is not terminated; the right of distress depends on the existence of a valid lease, and termination of the lease is inconsistent with this remedy. Many landlords currently try to manufacture circumstances where distress is commenced and perfected simultaneously with the termination, but this is not usually successful under judicial scrutiny[13]. Distress follows the goods[14], and a punitive obligation to pay the landlord twice the value of the goods may be imposed by a court where assets are wrongfully removed from the premises without the consent of the landlord[15].

- On non-payment of rent for over 15 days, elect to terminate the lease and to re-enter the premises on such termination[16]. This is always a good idea if the franchisor is aware of an impending bankruptcy, for the reasons set out below. The landlord will gain control over the location without having to worry about occupation and disclaimer or assignment by a trustee in bankruptcy. Further, the landlord is able to deal directly with the landlord on the head lease if it is a tenant thereunder, and either retain or forfeit the head-lease and withdraw from the location. The franchisor can insert a new sub-tenant without having to assign the lease or, in some cases, seek the approval of the landlord.

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13 as in Re Ontario Store Fixtures [2002], where D&R Properties attempted this action, and failed as against the CCAA Monitor

14 s. 48 of the Commercial Tenancies Act ("CTA")

15 s. 50 CTA

16 s. 18(1) of the CTA

- bring an action on the covenant of the lease for accelerated rent[17].

Termination of the Franchise Agreement

The franchisor will usually have many monetary and non-monetary events of default set out in the franchise agreement. The courts are consistent in finding that any termination by the franchisor must be done in accordance with the franchise agreement. This may also be subject to compliance with the *Competition Act*, as noted below. This judicial strictness is likely because of the common existence of unequal bargaining positions at inception of the franchise agreement. A franchisor can usually anticipate liberal application of the rule of *contra proferentum*, meaning that ambiguities in the franchise agreement will usually not be resolved in its favour. In Ivey v. Oakrun Farm Bakery Ltd.[18], the court held that the termination of a distributorship agreement was not in accordance with the distributorship agreement. The consequence to the grantor of the distributorship was that the termination was invalid, and the distributor was to be reinstated to the position it would have been in had there been no attempted termination. The defence of mitigation of damages was not open to the company who had sought the termination, with the result that the damages and costs of the decision were heavily weighted against the company. Termination of franchise agreements is dealt with in greater detail later in the course.

Injunctions

Injunctions are an extraordinary remedy that can have very serious ramifications on the franchise relationship. In most cases, the granting of an injunction will greatly impact the final outcome of the dispute between the parties. Mr. Goldman deals with these in his paper from the franchisee's perspective. From the franchisor's point of view, these remedies are employed in the enforcement of non-compete provisions of the franchise agreement, but can also be used where there is some dispute relating to intellectual property of the franchisor where that is used or disseminated by the franchisee contrary to the terms and conditions of the franchise agreement. They may also be useful in the case of a dispute over the right to payments of royalties, or in cases of sale of the franchisor's product on prices or terms that are contrary to the terms and conditions of the franchise agreement.

In order to obtain an injunction, the franchisor will have to satisfy a court with respect to the tripartite test defined in R.J.R. MacDonald Inc. *v.* Canada[19]*:*

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[17] Highway Properties Ltd. V. Kelly, Douglas & Co. [1971] S.C.R. 562

[18] [2002] O.J. No. 3007 (S.C.J.)

[19] R.J.R.-MacDonald Inc. *v.* Canada (Attorney General) (1994), 111 D.L.R. (4th) 385 at 402 (S.C.C.).

1. There is a serious issue to be tried;
2. The party seeking the injunction will suffer irreparable harm if the injunction is not granted; and
3. The balance of the convenience favours granting in the injunction.

With respect to the first branch of the test, a court will require the franchisor to establish a strong *prima facie* case where the granting of the interlocutory injunction would effectively end the litigation. For instance, an order to the effect that the franchisee renovate its premises[20] or upgrade its equipment in accordance with the provisions of the franchise agreement may significantly limit the franchisee's ability to carry on business.

The irreparable harm referred to in the second part of the test is defined as harm for which an award of damages would not be a sufficient remedy. Some examples of irreparable harm include one of the parties being unable to continue its business[21] or a franchisor sustaining permanent market loss that is incapable of being quantified.[22] The evidence of harm must be clear, not speculative.[23]

The final element to be considered by the court is the balance of convenience. In other words, the court is asked to perform a balancing act between the two parties and determine which of the two would suffer the greater harm if the injunction is granted. The factors considered by the court will be dependant upon the specific facts of the case.

The party seeking an injunction must give an undertaking to the court that it will abide by any order considering damages that may ultimately be made if the court later decides that the granting of the injunction has caused damage to the defendant. If the injunction is later set aside, the injured party who has suffered damages as a result of the injunction can look to the undertaking for protection. While a court can relieve this requirement where it is in the interests of justice to do so,[24] a franchisor will need to weigh this factor in deciding to bring an injunction motion.

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[20] This is common with car dealership and health club franchises, for example.

[21] Atlantic Corrosion Control Ltd. *v.* Rust Check Canada Inc. [1998] N.S.J. No. 81 (N.S.S.C.)

[22] *R.J.R. MacDonald, supra* note 19 at 385.

[23] N. Rabinovitch, "Fighting and Defending Injunctions" 1999 Fall Legal Symposium, November 4, 1999 at p. 8.

[24] Equitas Investment Corp. *v.* Goodman (1987) 57 OR (2d) 795 (Ont. H.C.J.)

In light of the costly, time-consuming, and destructive nature of preparing for an injunction motion a franchisor would be wise to explore other avenues before embarking on this course of action.

Alternatives to Injunctive Relief

One alternative to seeking an interlocutory injunction is to commence an application for a permanent injunction. [25] Although the application would be similar to an interlocutory injunction, the franchisor will not be required to give an undertaking to pay damages. Further, a permanent injunction is final, subject only to appeal rights and procedures.

Alternatively, a franchisor may elect to simply serve a notice of termination of the franchisee agreement and the lease.[26] Should the franchisee wish to contest the termination, it will need to commence an application for relief from forfeiture. In all likelihood, a court in considering the franchisee's application will require it to remedy all breaches of the franchisee agreement. Thus, the franchisor obtains the effect of an injunction without having to give an undertaking to pay damages and meet the criteria for an injunction.

Another route for a franchisor to consider is arbitration. If the franchisee agreement contains an arbitration clause, the franchisor may wish to have the application for an injunction dealt with by an arbitrator. This approach may be attractive to both parties as the arbitrator is one who is selected by the parties. As a result, it is more likely that the arbitrator will have a greater understanding of franchising. A further advantage is that the arbitration is confidential and not a matter of public record. This may be important where a franchisor does not want to make its proprietary information available to its competitors or to the public. However, our experience is that arbitration clauses are not usually well drafted, or reviewed by litigation counsel before their insertion into the franchise agreement. The decisions of an arbitrator are not necessarily based upon the best or clearest legal position. The decisions of the arbitrators or the arbitration panel are usually not reviewable, except in judicial review applications which are time consuming and expensive in their own right. Judicial review applications are seldom successful, particularly for the franchisor.

Self Help

This can be described as the unofficial grab-bag of remedies which may arise in the franchise documents, or in the course of conduct in the administration of the franchise. They are described as remedies available to a party without proceeding through a judicial application. Some of them are quite risky for the franchisor. While not intending to recommend any of them, examples from a franchisor's perspective may include:

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[25] Rabinovitch supra note 23 at 18

[26] Rabinovitch supra note 23 at 19.

- Changes in payment terms for delivery, or a tightening of trade credit issued by the franchisor for the benefit of the franchisee, such as putting the franchisee on a COD basis. This can be common in marine or automobile dealership situations where the parts are required on a daily basis;

- Slowing down the supply of materials or inventory. Another variation of this is to not deliver the best or freshest grade of product and material available, diverting those to the more successful franchisee operations in the network;

- Increasing the frequency of supervision and consulting services by the franchisor, usually at the expense of the franchisee. This can send a message to the franchisee, as well as creating a better stream of information, or at least information about what information is missing, than existed prior to the advent of actual or suspected problems of the franchisee;

- Slowing down or altering the pattern and distribution of the rebates and volume allowances available. For example, the franchise agreement may grant the franchisor a broad discretion to decide who gets these, when they are paid, who they are disclosed to, and in what quantity. The franchisor may elect, either gradually or in a more immediate fashion, to alter its pattern or course of conduct in payment and disclosure of these entitlements, to reward the compliant and successful franchisees, and punish the dishonest or uncooperative ones[27].

- Buying the franchise back from the franchisee.

- Distress (examined earlier).

These types of actions may be inherent in the business practices of franchise networks that have been in business for a long time, and may be implemented without the benefit of legal advice. This type of action by a franchisor can be fraught with peril, in the current judicial climate. As is seen in the certification applications in the A&P cases, some of these will not be well regarded by a court. They will likely be viewed negatively by a court if the franchisor is challenged by an allegation that it has not met its duty to deal fairly and act in good faith. In a worst case scenario, it could be challenged as a breach of a fiduciary duty, and may be actionable by a certified class of franchisees even though not all franchisees are affected.

The franchisor also runs the risk of running afoul of section 61 of the *Competition Act* in pricing disputes[28], particularly if the sum total of its' actions are seen to amount to a

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[27] As in the allegations contained in the Great Atlantic & Pacific cases now in continuing litigation.

[28] Section 61 makes it a criminal offence to “refuse to supply a product to or otherwise discriminate against any other person engaged in business in Canada because of the low pricing policy of that other person”. This could lead to a criminal liability with an unlimited fine, a maximum of 5 years' imprisonment, or both.

constructive termination of the franchise agreement. Prosecutions of this type are rare, but their threat is a deterrent in these situations.

The franchisor is always advised to obtain a legal opinion before continuing or commencing any of these types of remedies to know where the dangers lie. This is important, from the franchisor's perspective in this ever changing and increasingly hostile legal environment.

ii. Franchisee Proposals To Creditors

An insolvent franchisee may try to avoid bankruptcy by taking advantage of the proposal provisions under the BIA.[29] This means that the franchisee can present its creditors with a plan to compromise its debts, liabilities, and obligations in an effort to continue its operations, and to forestall enforcement actions against it in the interim period. If a franchisee is able to obtain the approval of its creditors to this plan, and the plan receives the approval of the court, the proposal will be a contract that is legally binding upon all creditors. Provided that the proposal has thereafter been fully performed in accordance with the approved plan, the franchisee can continue its operations and avoid bankruptcy. If it defaults in the plan, or fails to get both creditor and court approval of the plan, the franchisee is automatically bankrupt. In that case, the proposal trustee becomes the trustee in bankruptcy.

The process begins with the franchisee filing a notice of intention to file a proposal with the Official Receiver. Once the franchisee files a notice of intention to file a proposal[30], it automatically obtains a 30-day stay of proceedings[31], thus gaining protection from both secured and unsecured creditors. Within this 30 day period, the franchisee must file a proposal with the court or else the franchisee will be deemed to have made an assignment in bankruptcy.[32] This time to file a proposal can be extended by the court upon application by the debtor.[33]

As a result of the statutory stay of proceedings, no creditor may attempt to collect debts due by way of self-help remedies, court proceedings or the enforcement its security. In particular, a franchisor cannot terminate the franchise agreement or a commercial lease despite provisions expressly defining insolvency or the filing of a notice of intention as

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[29] S. 50(1) BIA

[30] S. 50.4(1) BIA

[31] S. 69.1(1) BIA

[32] S. 50.4(8) BIA

[33] s. 50.4(9) BIA

an event of default.[34] Any provisions of this nature in a franchise agreement are of no force and effect.[35]

However, the stay would not apply to a franchisor who has served the s. 244(1) notice required under the BIA for realization of security before the franchisee files its notice of intention to file a proposal. In certain cases, an aggrieved franchisor may apply to the court for a "carve-out" order in which the stay would be lifted. This would permit the franchisor to take steps to enforce the terms of the franchise agreement.[36]

A franchisor will likely wish to play a large role in any arrangements made with the creditors of the franchisee. Thus, a franchisor may choose to file a proof of secured claim with the proposal trustee. This would entitle the franchisee to vote on all questions relating to the proposal in respect of the entire claim, and would mean that the franchisor would also receive notice of any filing into bankruptcy on failure of the proposal process.

iii. Effect of a Proposal on Leases of Real Property and the Franchise Agreement

As noted above, no party or creditor can terminate an agreement with the insolvent franchisee once a proposal or a notice of intention has been filed. Therefore, once the stay has been activated, a franchisor/landlord would be precluded from terminating the franchise agreement or a lease of real property.[37]

However, the stay does not prohibit creditors from requiring payments to be paid in cash for goods, services, use of leased or licensed real or personal property or other valuable consideration provided after the filing of the notice of intention.[38] As such, the franchisor landlord could require the insolvent franchisee to make payments for royalties, equipment lease payments, and its continued use of the leased premises during the stay period on a per diem basis. An order of the court could be sought seeking a more frequent payment period, for example bi-weekly in advance rather than monthly. Should the franchisee fail to submit rental or royalty payments to the franchisor/landlord, the franchise agreement or lease can be terminated by the franchisor, despite the stay of proceedings, with an application to the court.

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[34] S. 65.1(1) BIA

[35] S. 65.1(5) BIA

[36] S. 69.4 BIA

[37] S. 65.1(1), (2) BIA

[38] S. 65.1(4) BIA

Alternatively, the franchisor landlord could also consider seeking a "carve-out order" for a declaration permitting it to terminate the franchise agreement or lease (or the franchise agreement) on the basis of financial hardship to the franchisor.[39]

Depending upon the circumstances, a franchisor may be concerned that the franchisee will disclaim its franchise agreement or lease. Under s.65.2(1), an insolvent person may, at any time between the filing of a notice of intention and the eventual proposal, disclaim the lease upon giving 30 day's notice to the landlord. If a franchisor is the landlord of the property and it wants to regain control of the premises, this may be a positive development. However, if the franchisor is tenant under the head lease (with the franchisee as a subtenant), it may be faced with a claim by the landlord for the amounts due under the lease.

In response to this notice, the franchisor landlord may apply to the court within 15 days after receiving the disclaimer for a declaration that the disclaimer does not apply. A court is required to make such a declaration unless the insolvent franchisee can satisfy the court that a viable proposal cannot be made without the disclaimer of the lease.[40]

If disclaimed, the franchisor landlord loses its claim against the franchise for accelerated rent and its claim for damages against the franchisee may be limited under the provisions of s. 65.2(4) of the BIA.

The franchisor may not terminate or amend any agreement, including a franchise agreement or licencing agreement, with the insolvent franchisee without a carve out application to the court[41]

iv. *Companies' Creditors Arrangement Act*

This is a companion statute to the BIA, providing another form of insolvency regime for businesses in Canada. Like the proposal provisions in the BIA, the CCAA permits a debtor to formulate a plan to meet the demands of its creditors while under the umbrella of a protective stay. The stay is contained in the initial order, and can run indefinitely, unlike the maximum time-limited stay of up to five months allowed under BIA proceedings.

Although there are no reported cases involving a franchisee applying for protection under the *Companies' Creditors Arrangement Act*[42], it is certainly possible. One reason for this is that in order to make use of the CCAA, a debtor must have claims against it

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[39] S. 65.1(5) BIA

[40] s. 65.2(3) BIA

[41] s. 65.2 (6) BIA

[42] R.S.C. 1985, c. C-36 (the "CCAA")

that exceed $5,000,000.[43] The situation of a "master franchisee" could invoke this situation, where the number of sub-franchisees is enormous (see footnote 1). It is more likely that an insolvent franchisor will be reorganized under CCAA, and the consequences to the franchisee are discussed in the companion paper prepared by Mr. S. Goldman.

Although the proposal provisions of the BIA afford a faster and more flexible tool, the CCAA may be more appropriate for insolvent franchisees with a large debt load. The process is usually commenced by the debtor franchisee bringing an *ex parte* application seeking the protection of the stay provisions of the CCAA.[44] Once satisfied that the franchisee meets the requirements of the CCAA, the court will declare that the debtor is a company to which the CCAA applies. It will also grant an order staying all proceedings and restraining creditors from taking any steps against the debtor. All material contracts, including executory contracts such as leases and licences will be preserved, regardless of their default and termination provisions. The initial order is usually obtained ex parte, and the franchisor, along with all the other creditors, is usually given little, or no time to prepare for the effects of the order.

v. Receiving Order Under BIA

A franchisee may fail in the attempt to get a proposal tabled and approved. It may also be petitioned into bankruptcy by one or more its unsecured creditors[45] where it has not commenced any form of Division I proposal under the BIA. Alternatively, the franchisee may acknowledge that its financial difficulties are insurmountable and decide to make an assignment into bankruptcy for the general benefit of its creditors.[46] The franchisee will be deemed to be bankrupt upon the date that the receiving order is made or an assignment is filed. There are no special rules for bankrupt franchisees under the BIA.

In either case, all of the franchisee's right, title and interest in all of its property vests in the trustee in bankruptcy from that point forward.[47] The trustee's mandate then becomes collecting and realizing upon the bankrupt's assets to maximize recovery to the estate.

On filing of the receiving order, s. 69.3(1) of the BIA provides for another stay of proceedings. The practical effect is that the franchisor will be precluded from commencing an action against the franchisee for any reason, including with respect to any arrears or royalties arising under the franchise agreement. The franchisor may

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[43] s. 3(1) BIA

[44] ss. 11(2) and (3)

[45] S. 43 BIA

[46] S. 49(1) BIA

[47] s. 71(2) BIA.

apply to the court to have the stay lifted by showing that it has suffered material prejudice, and other equitable grounds[48]. However, the bankruptcy of the franchisee does not preclude a secured creditor from otherwise realizing or dealing with its security[49]. In light of this, it is prudent for franchisor to ensure that the franchise agreement contains a provision for the granting of security interests over the assets of the franchisee, and for the franchisor to perfect its security interests under PPSA.

vi. Impact of the Receiving Order upon the Lease Arrangements

In the event of bankruptcy, the franchisor/landlord will lose a great deal of control over the location and the assets contained therein. For example, the franchisor will be precluded from commencing any distraint by the trustee in bankruptcy, and from completing any unperfected distress remedy which has been commenced against the goods of its tenant for arrears of rent. Distress is generally perfected on seizure completion of sale of the assets, depending on the fact situation. In addition, as the lease is in the name of the franchisor, the franchisor remains liable for any rental arrears and future rent. If the leased premises are no longer ideal, this obligation could pose a burden for a franchisor.

On the other hand, a franchisor may be faced with losing an attractive location should its franchisee file for bankruptcy. When a receiving order is made against or an assignment is filed by a bankrupt tenant, a trustee may:

(a) occupy the premises;

(b) surrender possession or disclaim the lease;

(c) retain the premises and lease for the whole or any portion of the unexpired term (and any renewals) subject to payment of rent under the lease, for which the trustee becomes personally liable; or

(d) assign the lease to a third party, provided that all arrears of rent have been paid to the landlord. The third party must covenant to observe and perform the terms and conditions of the lease and conduct a trade or business that is not reasonably of a more objectionable or hazardous nature and who is approved by a judge as a person fit and proper to be put into possession.[50]

From a franchisor/landlord's perspective, these provisions can have a significant impact on its ability to control the premises. If the location is considered to be a superior one, and the trustee chooses to assign the lease, the franchisor will want some element of

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[48] Schroeder v. Schroeder (1993), 19 C.B.R. (3d) 316,

[49] s.69.3(2) BIA

[50] *Commercial Tenancies Act* (Ontario), ss. 38 and 39 ("CTA")

control over the selection of the new tenant. As such, it is very important that the franchisee agreement be tied to the lease, contain restrictive wording in its use clause and that the franchisee be required to conduct the franchise business in accordance with the terms of the franchisee agreement. If these provisions are encapsulated in the franchise agreement, a trustee of the franchisee/subtenant will only be able to assign to a franchisee approved by the franchisor. To facilitate this process, the franchisor should work closely with the trustee in order to maintain a level of control over the assignment.

On the other hand, if the lease is disclaimed by the trustee, the franchisor landlord's claim for rent will be limited to a preferred claim[51] for the arrears for the three months immediately preceding the bankruptcy and accelerated rent for a period of three months following the bankruptcy (provided that there is an acceleration clause in the lease).[52] Further, the landlord's claim is further restricted as it cannot exceed the realization from the property.[53] The trustee's payment of occupation rent must also be credited against the accelerated rent.

Many of these consequences can be avoided if the franchisor landlord has been able to terminate the lease prior to the franchisee's bankruptcy.

vii. Impact of the Receiving Order upon the Franchise agreement

One of the assets that a trustee will be particularly interested in is the franchise agreement between the franchisor and the franchisee. By operation of s. 71(2), the benefit of any executory contracts, including franchise agreements, vests in the trustee in bankruptcy.[54] The bankruptcy of the franchisee does not automatically terminate a contract entered into by a bankrupt or constitute a breach of contract, unless this is specifically provided for in the agreement itself. However, my view is that a purported automatic termination on bankruptcy without notice to the franchisee would not be enforceable against a trustee because of the stay, and further because most agreements mandate the issuance by the franchisor of a notice of termination to make the purported termination effective.

Provided that the franchise agreement has not been terminated <u>before</u> the bankruptcy of the franchisee, the trustee may, with the permission of the inspectors, carry on the business of the bankrupt until the business can be wound up or sold.[55] In most cases, this means simply seizing and selling the assets, and in some rare circumstances operating part or all of the business as a going concern for some limited period of time

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[51] S. 136(f) of the BIA

[52] s. 38(1) of CTA

[53] s. 136(f) BIA

[54] <u>Potato Distributors Inc.</u> *v.* <u>Eastern Trust Co.</u> (1955), 35 C.B.R. 161 (P.E.I. C.A.)

[55] S. 30(1)(c)

to either finish work in progress inventory, or to maintain some possibility of obtaining "going concern" value on realization[56].

In some cases, the trustee would also inherit the franchisee's right to use the franchisor's trademark and other rights contained in the franchise agreement. Charged with the objective of maximizing the realization of the franchisee's assets, the trustee will likely attempt to sell or assign the goodwill and trademark to a third party in an attempt to generate realization proceeds. However, the franchisor will want to maintain control over its trademark so that it is not diminished in value by its purchase by a third party who is not a suitable franchisee. To do this, the franchisor must include prohibitions on assignment of the patents and trademarks without the express prior written consent of the franchisor.

The trustee's operation of the business as a going concern, the use of its trademark, and the impact that this will have on the franchisor's goodwill in the marketplace, will be of particular concern to the franchisor. The franchisor will want to ensure that the value of the franchised location is not eroded by the trustee's inability to maintain the level of service expected by the franchisor and its customers. Another concern is the possibility that the public may perceive that the bankruptcy of the franchisee is a reflection that the entire franchise is in peril. To avoid this, the franchisor and trustee have the option of working on a cooperative basis to maintain the standards until a mutually suitable replacement franchisee is found.

For these reasons, the franchisor should ensure that the franchise agreement provides that the trademark cannot be transferred without its consent and that an assignee must enter into a new franchise agreement if it wishes to continue the business of the bankrupt.

On other hand, if the franchisor has terminated the franchise agreement before the bankruptcy (or the term in the agreement has expired), the franchise agreement does not form the property of the estate. As the contractual relationship between the parties has expired, it cannot be resurrected through the bankruptcy proceedings. This leaves the franchisor free to negotiate new franchise agreements with (hopefully) financially stable franchisees.

Having said this, it is certainly possible that a trustee could take the position that the franchise agreement was not validly terminated prior to the filing of the bankruptcy petition. In most cases, the franchise agreement will be one of few valuable assets that could be sold or form part of a reorganization plan. If it is unclear whether the franchise agreement was validly terminated before the bankruptcy, the franchisor may consider bringing an application in Bankruptcy Court for a declaration that the agreement was validly terminated and not the property of the estate.

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[56] This is usually only done where the actual purchaser is identified, or where the business is in demand and is readily marketable.

As such an application could prove to be unnecessarily costly to the franchisor. A franchisor should insert clear termination clauses in the franchise agreement to ensure that there is no ambiguity regarding the steps that the franchisor must follow in terminating the franchise agreement and the effective date for the termination. Assuming that the franchise agreement includes these elements, this will certainly minimize any dispute with the trustee as to whether the agreement was terminated before the bankruptcy of the franchisee.

IV. RECOMMENDED TERMS FOR FRANCHISE AGREEMENTS

Our recommendations for critical terms in the franchise agreements have been set out in the text above. To summarize:

Security Interests

In all cases, the creation of security interests in all of the undertaking and assets of the franchise is recommended. Those interests can be specific to the inventory or equipment purchase money security interests, or can be in the form of a general security agreement. These terms should be included in the specific lease provisions to capture the financing and control interests in the trade fixtures and the fixtures intended to form part of the realty. All interests should be registered, where necessary against the lands, and also in accordance with the provisions of the PPSA as required for pmsi filings and normal perfections of the interests. The benefits of doing this allow greater control of the business premises and assets notwithstanding the commencement of an array of insolvency proceedings, and in some cases defeat many of the powers devolving to a monitor, proposal trustee, receiver, or otherwise.

Fiduciary Duties

An express exclusion of any fiduciary relationship binding the franchisor should always be included in the franchise agreements.

Guarantors

The franchisee should always be given the positive duty to notify guarantors of all financial information, material changes in the business and its financing, and to confirm the issuance of such notification to the franchisor on a regular basis. This does not absolve the franchisor from also notifying the franchisees, but does help to protect the guarantees.

Leases and Licences

These rights should not be assignable without the expressed prior written consent of the franchisor being first obtained. No assignee should be approved without also qualifying as a franchisee. The obligation on the franchisor to act reasonably should be excluded. Any assignee must satisfy the qualification criteria of the franchisor. Any purported transfer without this should be expressly stated to be void. This may not actually work at the time, for instance in the case of a vesting order issued by a court in a receivership in

the face of such provisions, but it is always better to have that protection in the agreement as a starting point. The lease arrangements made without the franchisor as a head-tenant should always include, to and in favour of the franchisor, a right of notification of default by the franchisee under the lease, a cure period, and an option but not an obligation to assume the lease.

Waivers

Waivers relating to negligent or inadvertent misrepresentation for actual representations or warranties should be inserted to protect the franchisor. However, these will always be subject to the statutory disclosure requirements of the applicable statute.

There should also be specific waivers of rights to entitlements, rebates, and inducements accruing to the franchisor, with a specific example inserted, if available. This could include the waiver of a duty to distribute equally to all franchisees, and for the franchisor to maintain complete and absolute discretion in that regard, even though this may be subject to overriding statutory duties.

Financial Disclosure and Information from third parties

In order for a franchisor to remain abreast of any financial problems being faced by a franchisee, the franchise agreement should include a requirement that a franchisee must provide financial statements on an ongoing basis or permit the franchisor the periodically audit the franchisee's books and records. By regular monitoring of the financial health of the franchisee, the franchisor can be prepared to terminate the franchise agreement upon learning of the insolvency of the franchisee. As discussed above, if a franchisor is able to successfully terminate the franchise agreement before the franchisee becomes bankrupt or it makes a proposal, it will be able to maintain better control of the franchisee's licence and leased premises.

Such clauses should always contain the express and irrevocable prior consent of the franchisor to contact third parties, including banks and critical suppliers, and discuss the financial affairs of the franchisee. The operating lender should also be expressly allowed to give current banking information, and notify the franchisor in the event of any default with the bank. Without this protection, the franchisor may be limited in the amount of information that it can give and receive from the bank and other critically involved third parties.

Events of Default

In order to avoid ambiguity as to the circumstances in which a franchisor can terminate the franchise agreement, the agreement should clearly set out the events of default. The list should include the franchisee's failure to pay any amount or perform any obligation and the insolvency or bankruptcy of the franchisee or the appointment of a receiver. The agreement should clearly provide that upon the occurrence of an event of default, the franchisor is entitled terminate the franchise agreement. It could be useful to build in automatic termination on the commencement of insolvency proceedings, and

specifically in the situation of the issuance of a receiving order, subject to the discussion set out above.

V. CONCLUSION

A franchise agreement, and, by extension, the franchise relationship, can be a very complex system of agreements, licences, acknowledgements, indemnities, leases and security documents. These documents are usually drafted by and to the benefit of the franchisor. However, when attempting to enforce its various rights against an insolvent franchisee, the franchisor should recognize that it may face certain barriers erected by evolving legislation, the franchisee's creditors, and other interested parties.

Although a franchisor can exercise those remedies available to it upon the financial default of the franchisee, it does not operate in a vacuum. In achieving it goals, not only must a franchisor ensure that it complies with the duties imposed upon it by statute, it must contend with the rights of competing creditors such as the franchisee's banker, landlord, suppliers, guarantors, court-appointed representatives such trustees in bankruptcy, receivers, and/or monitors.

To minimize disruption to the franchise network and the brand, careful thought must be given to the franchise agreement at its inception, and should be drafted and negotiated with all of these concerns in mind. Similar care needs to be taken in the day to day administration of the franchise network.

The assistance my litigation associate, Mr. Craig Mills, in the preparation of this article is most gratefully acknowledged.